Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
Request for Review of a Decision of the Universal Service Administrator by	)	USAC's March 29, 2011 Decision Regarding Form 471 Applications No. 295389, 337296, 377451, 398823, and 398827
Joseph M. Hill, Trustee in Bankruptcy for Lakehills Consulting, LP	)	CC Docket No. 02-6
Schools and Libraries Universal Service Support Mechanism	)	

REQUEST FOR REVIEW OF A DECISION OF THE UNIVERSAL SERVICE ADMINISTRATOR/WAIVER

Joseph M. Hill, trustee in bankruptcy for Lakehills Consulting, LP (the "Lakehills Trustee" and "Lakehills"), by counsel, and pursuant to the rules of the Federal Communications Commission ("FCC"), 47 C.F.R. §§ 54.719- 54.721, hereby timely requests review of the March 29, 2011 decision of the Universal Service Administrative Company ("USAC") to rescind and recover all previously committed E-Rate funding for Form 471 Application Nos. 295389, 367296, 377451, 398823, and 398827 (the "USAC Decision"), all of which relate to work performed under contracts issued by the Houston Independent School District ("HISD"). The Lakehills Trustee is an interested party to request review because the Lakehills bankruptcy estate currently holds the Service Provider Identification Number ("SPIN") for the work completed under the funding request numbers ("FRNs") associated with the Form 471 Applications at issue in the USAC Decision. As detailed below, the Lakehills Trustee requests that FCC reverse the USAC Decision as a matter of law, or, alternatively, grant a waiver of the FCC's rules.

I. SUMMARY

USAC denies payment of amounts due and owing to Lakehills, a contractor who successfully provided E-Rate services to HISD, and seeks return of amounts previously paid, all on the ground that where any party to an E-Rate transaction violated procurement regulations, no one, violator or otherwise, may receive or retain E-Rate funds. This draconian result is dictated by an FCC rule that presumptively prohibits USAC and the FCC from expending funds on any E-Rate contract tainted by a procurement illegality (the "FCC Rule" or the "Rule"). *Schools & Libraries Universal Service Support Mechanism,* Fifth Report and Order, CC Docket No. 02-6, Order, FCC 04-190, 19 FCC Rcd. 15808 (2004); *see also* 47 C.F.R. § 54.503. Under the Rule, payment is prohibited regardless of (i) who engaged in the illegal conduct or (ii) whether the contractor successfully delivered value to the library or school. In the present circumstance, USAC is withholding payment of at least \$20.1 million[1] invoiced by Lakehills for the successful completion of the work associated with Form 471 Application Nos. 295389, 367296, 377451, 398823, and 398827 and is seeking return of approximately \$62 million[2] previously paid. While HISD continues to enjoy the fruits of Lakehills' labor, facilitated by Lakehills' third-party financial backers, the Lakehills Trustee and Lakehills' financial backers are left empty handed,

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[1] Copies of the invoicing records for the FRNs associated with this amount are attached as Exhibit A.

[2] The Commitment Adjustment Letters associated with Forms 471 Numbers 295389 and 377451, cited in the USAC Decision, do not appear to have been included with the Decision. Based on best efforts to discern the total USAC seeks in return, the attached Exhibit B outlines the FRNs associated with the Form 471 Applications and associated dollar amounts.

except for HISD's payment of its 10% of the contract price for the successful completion of the projects.[3]

This unjust and uneven outcome is not mandated by law. Neither USAC nor the FCC is bound by the FCC's self-created Rule. The Rule exists only as the result of a misplaced expansion of the U.S. Supreme Court's holding in *OPM v. Richmond*, 496 U.S. 414 (1990), which held that a Federal agency may not commit money in ways not authorized by statute. The FCC has expanded that holding to prohibit the expenditure of E-Rate funds in virtually all circumstances where there is an alleged impropriety, not just in cases of violations of the Federal E-Rate statute.[4]

As explained below, expansion of the Rule takes it well outside the norm of established law on remedies available to parties involved in transactions tainted by illegality. Examples of the legal norm, which the Rule violates, include (1) the Federal False Claims Act, 31 U.S.C. §§ 3729-3733 ("FCA"), the Government's primary statutory tool for recovering amounts that the Government allegedly has paid out due to some sort of fraudulent activity, like that alleged here; (2) contract law where damages for breach are offset by the value of what the breaching party actually delivered; (3) contract law where the performing party has equitable remedies for performance even where the contract is found to be *void ab initio* because of fraud in the

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[3] Lakehills filed for bankruptcy under Chapter 7 of the Bankruptcy Code, 11 U.S.C. §§ 701, *et seq.*, in 2009, largely due to USAC's refusal to compensate Lakehills. *See Lakehills Consulting, L.P.*, No. 09-34049 (Bankr. S.D. Tex, filed June 5, 2009). Lakehills' creditors in the bankruptcy (the "Lakehills Creditors") consist of secured creditors Textron Financial Corporation ("TFC"), the Dallas and Harris Counties of Texas and the Carrollton-Farmers Branch ISD, and many unsecured creditors. The interests of all are represented by the Lakehills Trustee. Any payment by USAC to Lakehills for the Funding Request Numbers ("FRNs") in question will go to the Lakehills Trustee for distribution to the Lakehills Creditors and not to any principals of Lakehills or its predecessors.

[4] This request for review seeks confinement of the FCC Rule to violations of statute only, consistent with *OPM v. Richmond*. As explained below, *see* Section IV, if the FCC determines not to so confine the Rule, the circumstances of this E-Rate funding fall squarely within the authority provided the FCC to waive application of the Rule.

contract's formation; and (4) the Federal Assignment of Claims Act, 31 U.S.C. § 3727; 41 U.S.C. § 15 ("ACA").

Enforcing a rule that so fundamentally ignores the general principles of fairness and justice evidenced in the above examples is questionable public policy as well. A rule denying all compensation to a party who actually creates and delivers value to the schools and libraries, regardless of the party's association with questionable or even illegal conduct in E-Rate awards, will discourage, if not eliminate, future participation by such parties and others similarly-situated, effectively frustrating the purposes of the E-Rate program. Additionally, a rule that treats similarly situated parties unequally, as does the Rule here, will also drive participants away.[5]

Because USAC's decision is based completely upon the FCC Rule, which itself is not warranted and should be set aside, USAC's decision cannot stand. The facts are: (1) HISD and the Federal government indisputably received value under the contracts in question, thus accomplishing the primary objective of the E-Rate program,[6] and (2) HISD, whose own conduct led USAC to rescind funding commitments and demand return of amounts previously paid to Lakehills, has continuously enjoyed the benefits of the Lakehills-provided equipment and services at virtually no cost to itself or to USAC. This abject injustice makes it obvious that the Rule itself is flawed or, at a minimum, is inappropriately applied here.

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[5] As discussed later, USAC's Decision forces the Lakehills bankruptcy estate to bear almost the entire burden of the alleged wrongdoing in the award of the HISD contracts.

[6] The Federal government received value through the successful implementation of a specific statutory goal contained in the Telecommunications Act of 1996, Pub. L 104-104, 110 Stat. 56 (1996) (amending the Telecommunications Act of 1934) (codified at 47 U.S.C. §§ 151 *et seq.*) (the "Telecom Act of 1996"), to make information technology available to the nation's school children and in libraries which could not otherwise afford the technology. 47 U.S.C. § 254. The value to the Federal government and the nation was a more technologically savvy and educated citizenry.

II. FACTUAL BACKGROUND

A. The E-Rate Program

The Universal Service Fund's School and Libraries Program, commonly known as the E-Rate program, provides federal funding to local school districts and libraries to purchase computers and other technology equipment that, without such assistance, they could not afford. The program was designed to help schools and libraries gain access to the Internet and other digital technology while allowing them to use their scarce resources to support other critical aspects of educational reform. Program discounts are permitted for the acquisition of digital technology infrastructure such as telephone services, internet and website services as well as network equipment and services. The program was created as part of the Telecom Act of 1996.

E-Rate is administered by USAC, a not for profit corporation set up by the FCC to operate the fund. It is not funded through general appropriations, but rather through mandated payments from companies that provide interstate telecommunication services. *See* 47 U.S.C. § 254(d). The funds are used to provide discounts to schools and libraries. These discounts range from 20% to 90%, depending upon the number of children in the district who qualify for the federal school lunch program. *See* 47 C.F.R. § 54.505(c). Those benefiting from the discounts, schools and libraries, must commit additional resources including end-user equipment, software, staff training and other elements that are necessary to take full advantage of increased connectivity. Beneficiaries themselves may issue their own requests for proposals ("RFPs") and select the winning vendors. *See* 47 C.F.R. § 54.503. Those vendors are then paid with beneficiary funds and with Federal E-Rate funds provided by USAC. To invoice and obtain payment from USAC, the vendor must have a USAC-supplied SPIN.

B. <u>The HISD Contracts</u>

The HISD contract award decisions at issue in this request for review are those for E-Rate Funding Years 2002, 2003, and 2004. At the time of the awards, Analytical Computer Services ("ACS") held the SPINs under which work performed under those contracts could be billed to USAC.

1. Assignment of Contracts and Consolidation of ACS SPINs into Lakehills' SPIN

On January 1, 2007, Lakehills acquired all of the assets of Southwest Analytical Services ("SWACS") which, previously in March 2004, had acquired the assets of ACS, including ACS's contracts with HISD covering Funding Years 2002, 2003, and 2004. Declaration of John Jancar, attached at Exhibit C ("Jancar Decl.") ¶ 3. Lakehills acquired these assets with the knowledge and approval of HISD. *Id.* ¶ 4; USAC Decision, Tab 114. So that it could be paid for work previously performed by ACS, Lakehills began the process of consolidating the ACS SPINs into Lakehill's SPIN. This process was completed on March 9, 2007 with USAC's approval. USAC Decision at 22. After that point, Lakehills invoiced USAC for work performed under the Funding Year 2002, 2003 and 2004 awards.

At the same time USAC approved the SPIN consolidation, USAC knew of allegations of taint involving HISD's award of the E-Rate contracts for Funding Years 2002, 2003, and 2004. Indeed, just ten days after USAC's approval of the SPIN consolidation, USAC sent Mr. Frank Trifilio, former owner of ACS and a minority owner of Lakehills, a letter in which USAC raised four concerns: (1) ACS's apparent ties to Micro Systems Enterprises ("MSE") and its owner, Mr. Frankie Wong, who were under investigation by the U.S. Attorney's Office for bidding improprieties in connection with the Dallas Independent School District ("DISD") E-Rate contract awards, (2) a comment by a HISD board member raising questions about HISD's own bidding process and the involvement of Frankie Wong in that process, (3) political donations by Mr. Trifilio to members of the HISD Board, and (4) allegations that ACS had violated the ethics rules of its information technology vendor, Hewlett Packard. *Id.* ¶ 6. Mr. Trifilio responded in detail in a letter addressing the allegations and concerns USAC raised in its letter. Federal Express confirmed delivery of Mr. Trifilio's letter to USAC with a receipt. Many months later when USAC first advised Lakehills that USAC would be withholding payments to Lakehills, USAC cited, in part, Mr Trifilio's failure to respond to USAC's letter, a claim belied by the Federal Express receipt. *Id.* ¶¶ 8-9.

USAC also began to delay E-Rate payments to Lakehills around the time of the SPIN consolidation. In response to Lakehills' inquiries, USAC identified internal USAC administrative issues as the reason for the delay. *Id.* ¶ 14. USAC failed to acknowledge that concerns about the propriety of the contract awards to ACS for Funding Years 2002, 2003 and 2004 were delaying payment. Indeed, USAC did not notify Lakehills that payments were being delayed for this reason until September 27, 2007 — after numerous communications and attempted communications between Lakehills and USAC on this very issue, and after Lakehills had, between May 2007 and September 2007, implemented a $17 million E-Rate switch project for HISD. *See id.* ¶¶ 14-20.

2. All Work Was Satisfactorily Performed Under the Contracts and There Is No Evidence to the Contrary

There has been no allegation — let alone any showing or citation of evidence — that the work performed for HISD under the contracts at issue here was in any way deficient. In fact, the work performed on the switch project for HISD between May and September 2007, to interconnect computers at different schools, was performed on an expedited basis because HISD wanted that capability in place before the start of the new school year. *Id.* ¶ 12. With funding from the Lakehills Creditors and through Lakehills' skill and effort, the project was completed on time.

C. The USAC Decision

Between the Fall of 2007, when Lakehills first learned that USAC would withhold payments to Lakehills because of allegations of improprieties concerning the awards of the Funding Year 2002, 2003 and 20004 HISD contracts to ACS, and March 29, 2011, Lakehills attempted to obtain payment from USAC for the work successfully completed under the contracts. During that period, in June 2009, Lakehills filed for Chapter 7 bankruptcy. As noted earlier, the leading cause of Lakehills' decision to file for Chapter 7 bankruptcy was USAC's failure to pay Lakehills for the E-Rate work it had successfully completed for HISD. *Id.* ¶ 25.

After a great deal of urging by the Lakehills Trustee, on March 29, 2011, USAC issued a series of Notification of Commitment Adjustment Letters and a "Further Explanation of the Administrator's Decisions" regarding the Form 471 Application Numbers that are the subject of this request for review. In these letters and decision, USAC found that all funding for the Form 471 Application Numbers at issue here should be rescinded and/or recovered. This decision was based entirely upon application of the FCC Rule.

III. THE USAC DECISION SHOULD BE REVERSED BECAUSE IT IS BASED ENTIRELY UPON THE FCC'S UNREASONABLE EXPANSION OF A SIMPLE PREMISE FROM THE U.S. SUPREME COURT'S DECISION IN OPM V. RICHMOND

USAC's decision should be set aside because it is based solely upon the FCC Rule, which is not required by law, is contrary to the FCC's own regulations, and is inconsistent with well-established legal principles governing the recovery of monies paid out by the Federal government. As explained below, the Lakehills Trustee respectfully requests reversal of the USAC decision as contrary to law.

A. The FCC Rule Is Not Required by Law

The FCC Rule requiring the withholding and recovery of all funds disbursed in connection with an E-Rate contract allegedly tainted by the giving of gratuities is not required by law. The FCC Rule began as a limited mechanism for recovering funds disbursed in violation of express statutory prohibitions. The FCC has expanded the withhold and recovery mechanism over time to include withholding and recovery for more than just statutory violations, to include regulatory violations. However, contrary to USAC's Decision, the FCC is not required as a matter of law to withhold and recover the funds in question.

The FCC's original order requiring recovery of funds contemplated recovery only where the recipient in question failed to satisfy the statutory eligibility requirements under the Telecommunications Act of 1996. *Federal-Joint Bd. on Universal Service, Changes to the Bd. of Directors of the Nat'l Exchange Carrier Ass'n,* CC Dockets No. 96-45, 97-21, FCC 99-291 (1999) ("*Commitment Adjustment Order*"). The Commitment Adjustment Order directed USAC to adjust certain commitments for discounted funding that had been made to schools and libraries where the applications (1) sought discounts for ineligible services, or (2) sought discounts for services to be provided for non-telecommunications carriers, both of which violated the express eligibility requirements of the Telecommunications Act of 1996. *Id.* ¶ 4; *see also* 47 U.S.C. § 254(h). The FCC outlined these express statutory requirements and concluded that the Supreme Court's ruling in *Office of Personnel Management v. Richmond* precluded the FCC from making payment for such statutorily ineligible services. *Id.* ¶ 7, n.14 (citing *OPM v. Richmond*, 496 U.S. 414, 424 (1990)). *Commitment Adjustment Order* ¶ 10.[7]

Based on its analysis of *OPM v. Richmond*, the FCC directed USAC to propose a plan for adjusting commitments of E-Rate funding made to schools and libraries where granting applications for such funding ***would violate a federal statute***. The FCC relied on the Debt Collection Improvement Act ("DCIA"), 31 U.S.C. § 3701(a), as the FCC's authority for recovering such funds.

On the same day the FCC issued the Commitment Adjustment Order, it also recognized a clear distinction between adjustments expressly ***required by statute*** and adjustments based on FCC rules. The FCC granted a temporary waiver of adjustment requirements for the first year of the program because the violations in question were regulatory competitive bidding requirements required by FCC rules, rather than statutory requirements. *Changes to the Bd. of Directors of the Nat'l Exchange Carriers Ass'n, Federal-State Joint Bd. on Universal Service*, CC Docket Nos. 96-45, 97-21, Order, FCC 99-292, 15 FCC Rcd. 7197, 7198, 7200 (1999) ("*Commitment Adjustment Waiver Order*"). The FCC cited applicant and service providers' reasonable reliance on funding in performance of actual work as further support of its limited waiver. *Id.* at 7200.[8]

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[7] In *OPM v. Richmond*, the Supreme Court rejected a claim of estoppel against the Government because it would have meant that money would be spent in violation of statutory conditions attached to the appropriation which made the money available for obligation. Because the Appropriations Clause of the United States Constitution requires all money spent from the U.S. Treasury to be in accordance with a congressional appropriation, the Court reasoned that when a condition is placed on an appropriation, the money in question can only be spent in accordance with that condition. If the condition has not been satisfied, payment would not comply with the appropriation and thus, in turn, would violate the Appropriations Clause.

[8] Of course, if *OPM v. Richmond* as applied to the E-Rate program prohibited expenditures of monies for all violations of competitive bidding or other rules or regulations in connection with the award of E-Rate contracts, the FCC could not waive such a requirement.

The FCC approved USAC's Commitment Adjustment Order implementation plan one year later. *Changes to the Bd. of Directors of the Nat'l Exchange Carriers Ass'n, Federal-State Joint Bd. on Universal Service,* CC Docket Nos. 97-21, 96-45, Order, FCC 00-350, 15 FCC Rcd. 22975 (2000) ("Commitment Adjustment Implementation Order"). The Commitment Adjustment Implementation Order reiterated that the FCC's recovery authority stemmed from a need to adjust commitments and seek repayment of funds where the disbursement in question violated the Federal Communications Act. *Id.* at 22976. Recognizing the limits of that statutory recovery, the FCC clearly stated that this recovery mechanism was "not intended to cover the rare cases in which the Commission has determined that a school or library has engaged in waste, fraud, or abuse." *Id.* at 22,980. Notwithstanding the authority cited, the Commitment Adjustment Implementation Order permitted USAC to withhold funding for either statutory ***or*** regulatory violations.

In subsequent years, the FCC expanded the Commitment Adjustment regime to permit recovery for an even broader range of regulatory violations. *See In the Matter of Schools and Libraries Universal Service Support Mechanism*, CC Docket No. 02-6, Order and Second Further Notice of Proposed Rule Making, FCC 03-323, 18 FCC Rcd. 26912 (2003) (seeking comment on a range of additional regulations). In 2004, the FCC allowed recovery to protect against waste, fraud and abuse in the E-Rate program. *Schools & Libraries Universal Service Support Mechanism,* Fifth Report and Order, CC Docket No. 02-6, Order, FCC 04-190, 19 FCC Rcd. 15808 (2004). Without citing any authority, the FCC explained that the expansion of the recovery regime to regulatory violations "is consistent with the requirements of the DCIA and the general intent of the *Commitment Adjustment Order*." *Id.* at 15813-14. The FCC then concluded that it would withhold payment where allegations of fraud, waste, or abuse are raised.

Id. 15817. The Fifth Report and Order also identified additional rules violations that warranted recovery.

In keeping with its ever-expanding interpretation of which regulatory violations require recovery of funds, the FCC has consistently found that a violation of the regulatory competitive bidding requirements obligates USAC to rescind and recover all funding associated with contracts allegedly tainted by the violation. *See, e.g.*, *In The Matter Of Request For Review Of A Decision Of The Universal Service Administrator By Lazo Technologies, Inc., et al.*, CC Docket No. 02-6, Order, 24 FCC Rcd. 10675 (2009). The only explanation the FCC has ever provided for this position is its passing reference to the ruling in *OPM v. Richmond* in the Commitment Adjustment Order.

As discussed above, *OPM v. Richmond* does not require such result. *OPM v. Richmond* simply stands for the unremarkable proposition that the government may not make a payment where an underlying ***statutory*** condition for the expenditure of funds has not been satisfied. *OPM v. Richmond*, 496 U.S. at 424-25. It does not address the question of whether ***any*** violation of a statute or regulation somehow relating to a government payment requires such a result — where the statute authorizing payments contains ***no*** provision stating that payment cannot be made if there is a non-compliance.

Neither the logic nor holding of *OPM v. Richmond* extends to the question of a proper remedy for alleged regulatory violations, because regulatory violations do not implicate the Appropriations Clause. The ***statutory*** condition on the appropriation was the key fact in *OPM v. Richmond.* 496 U.S. at 424 ("It means simply that no money can be paid out of the Treasury unless it has been appropriated by an act of Congress.") Neither *OPM v. Richmond* nor the

Constitution provides that payment of funds is forbidden if a rule or regulation imposed by the Executive Branch, allegedly relating to the payment decision, has been violated. Indeed, the very order on which the current FCC rule is based was rooted in a statutory — as opposed to regulatory — violation. *Commitment Adjustment Order*, ¶ 4. Moreover, the relevant statute here, the Telecom Act of 1996, which established the E-Rate program, does not require competitive bidding as a condition of the expenditure of funds — this requirement is a construct of FCC orders implementing the FCC's regulations. *See* 47 U.S.C. § 254(h); *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, FCC 97-157, 12 FCC Rcd. 8776, ¶ 570 (1997) (outlining the competitive bidding requirements under the Universal Services Program).

Accordingly, the FCC is not compelled by the Constitution, federal law, including *OPM v. Richmond*, or even its own regulations to withhold or fully recover in the event of a contract award allegedly tainted by violations of the FCC's competitive bidding regulations. To the contrary, the regulatory authority for such recovery is based on an inappropriately expansive interpretation of the Commitment Adjustment Order to circumstances not contemplated at the time the Order was issued. Such recovery is wholly unsupported by *OPM v. Richmond.*

B. A Proper FCC Rule Addressing Payments to Performing Contractors Who Allegedly Have Violated E-Rate Program Rules Would Follow Established Legal Principles

An FCC rule reflecting well-established legal principles would take into account the value delivered by a successful E-Rate contractor before determining the amount, if any, of a withhold or recovery. As noted earlier, there is no evidence, nor is there any allegation, that the work performed under the contracts at issue here was in any way deficient. Under the FCC Rule, however, the value received by HISD and the Federal government must be ignored. For this reason, the FCC Rule goes too far.

1. The False Claims Act Which, Like the FCC Rule, Authorizes the Government to Recover Monies Where There Has Been Fraudulent Activity, Requires Consideration of Mitigating Factors

The FCA authorizes the government to recover funds it has paid as the result of allegedly fraudulent activity by a claimant.[9] 31 U.S.C. §§ 3729-3733; *U.S. ex rel Steury v. Cardinal Health, Inc.*, 625 F.3d 262, 267 (5th Cir. 2010) ("The FCA is the Government's 'primary litigation tool' for recovering losses resulting from fraud."). The FCA regime requires: (1) that value the Government has received be taken into account in determining the Government's recovery for allegedly fraudulent claims; 31 U.S.C. §§ 3279-3733; *United States v. Bornstein*, 423 U.S. 303, 316 n.13 (1976) ("The Government's actual damages are equal to the difference between the market value of the tubes it received and retained and the market value that the tubes would have had if they had been of the specified quality."); *United States v. Sci. Applications Int'l Corp.*, 626 F.3d 1257, 1278 (D.C. Cir. 2010) ("*SAIC*"); and (2) that the government's knowledge of the facts which allegedly made a claim fraudulent be considered in determining whether the claimant acted with the requisite fraudulent intent at the time it submitted its claim *U.S. ex rel Ubl v. IIF Data Solutions*, No. 009-2280, 2011 WL 1474783, at *5 (4th Cir. Apr. 19, 2011). The FCC Rule currently incorporates neither of these tests before allowing a finding that a recipient of E-Rate funds has forfeited its right to be paid and to retain payments for work it successfully performed.

[9] Indeed, the government has intervened in an FCA *qui tam* action relating to the very contracts at issue in this request for review. *United States ex. rel. Richarson*, No. 05-cv-03836 (S.D. Tex. filed Nov. 14, 2005)

The very issue of whether value given must be taken into account in assessing FCA damages was recently litigated in the United States Court of Appeals for the District of Columbia Circuit in the *SAIC* case. In *SAIC*, a jury found that Science Applications International Corporation ("SAIC") had violated the FCA by seeking payments at the same time it was violating conflict of interest provisions in its contract with the Federal government. Specifically, the district court allowed the government to seek recovery of all payments made under the contract as its measure of damages. *SAIC*, 626 F.3d at 1264. The D.C. Circuit expressly rejected this argument, finding that under the benefit of the bargain test articulated in *United States v. Bornstein,* 423 U.S. 303, 316 n.13 (1976), the government can only recover the full contract value "where the government proves that it received no value from the product delivered" as a result of the false claim. 626 F.3d at 1278-79.

Consistent with the FCA, the FCC Rule should take value delivered to the school district into consideration before deciding to rescind and/or recover E-Rate funding. The USAC Decision does not do so.

Ironically, in the Lakehills' bankruptcy proceeding, the Federal government filed a Proof of Claim alleging, *inter alia*, that the government is entitled to recover damages under the FCA for false claims arising out of the award of the HISD contracts. Proof of Claim of the United States of America in *In re: Lakehills Consulting, L.P.*, Case No. 09-34049 (Bankr. S.D. Tex.), attached as Exhibit D ("Government Proof of Claim").[10] It would be strange, indeed, that in that proceeding, the value successfully delivered by Lakehills to HISD for the switch project would

[10] The Lakehills Trustee filed an objection to the Government Proof of Claim, and that action is currently stayed pending the outcome of this Request for Review.

be taken in account before determining damages, while before USAC and the FCC, the very same value is ignored.

2. Contract Law Accounts for the Value of Products and Services Delivered by a Breaching Party in Determining the Non-Breaching Party's Damages

The legal concept that value delivered by a defaulting party must be considered in fashioning remedies is well settled in contract law. When calculating breach damages, value received by the non-breaching party is factored in to prevent a windfall for the non-breaching party. Restatement (Second) of Contracts, § 347 cmt. b. ("If defective or partial performance is rendered, the loss in value caused by the breach is equal to the difference between the value that the performance would have had if there had been no breach and the value of such performance as was actually rendered.") Significantly, the HISD RFPs, which USAC accepted as support for the FRNs it committed to HISD, and whose language on gratuities USAC cites as grounds for imposition of the Rule here, USAC Decision at 15, support this very principle. The RFPs expressly provide that if Lakehills defaults, HISD is relieved of all obligations "***except to pay the value of the vendor's prior performance*** (at not exceeding the contract rate)." *See* USAC Decision, Tabs 35, 36, & 37.

Further, even where fraud is found in the formation of a contract resulting in a contract that is *void ab initio*, the contractor still may recover the value it delivered under theories of *quantum meruit* or *quantum valebant*. *See, e.g.*, *Flour Enterprises, Inc. v. United States*, 64 Fed. Cl. 461, 496 (2005) ("When a contract or provision thereof is in violation of law but has been fully performed, the courts have variously sustained the contract, reformed it to correct the illegal term, or allowed recovery under an implied contract theory; the courts have not, however, simply declared the contract void ab initio." (citing *AT&T Co. v. United States*, 177 F.3d 1368, 1376

(Fed. Cir. 1999)); *see also United States v. Amdahl Corp.*, 786 F.2d 387, 393 (Fed. Cir. 1986); *Gould, Inc. v. United States*, 67 F.3d 925, 930 (Fed. Cir. 1995).

3. Financial Institutions Which Fund Government Contractors Obtain Return of Their Investment to the Extent of the Contractor's Performance Regardless of Contractor Fraud

Under the Federal Assignment of Claims Act, 31 U.S.C. § 3727; 41 U.S.C. § 15 ("ACA"), government contractors may assign the proceeds of their contracts to financial institutions in return for contract financing. If it subsequently is determined, however, that the contract award was tainted by fraud not involving the financial institution, the government still is obligated to pay the financial institution up to the value the contractor delivered to the government. *See Arlington Trust Co. v. United States*, 100 F. Supp. 817 (Ct. Cl. 1951); *Chelsea Factors, Inc. v. United States*, 181 F. Supp. 685 (Ct. Cl. 1960).

C. USAC Seeks a Forfeiture from Lakehills Which Can Proceed Only Under the FCC's Regulations Governing Forfeitures, Not Under the FCC Rule

In addition, the FCC Rule further violates the FCC's regulations on forfeitures. A forfeiture is "the divestiture of property without compensation" or "the loss of a right, privilege, or property because of a crime, breach of obligation, or neglect of duty." *Black's Law Dictionary* 722 (9th ed. 2009). The FCC has specific regulations that must be followed in forfeiture actions, including required procedures, caps on the total monetary penalty, and a one-year statute of limitations. *See* 47 U.S.C. § 503(b); 47 C.F.R. § 1.80(b).

Regardless of how USAC labels its refusal to pay the E-Rate funds here, the refusal is tantamount to a forfeiture which, as indicated above, is "the divestiture of property without compensation" or "the loss of a right, privilege, or property because of a crime, breach of obligation, or neglect of duty." As a forfeiture imposed by USAC and the FCC, the action is subject to the FCC's rules on forfeitures.

The FCC has statutory authority to impose forfeiture whenever a person has "willfully or repeatedly failed to comply with any of the provisions of this chapter or of any rule, regulation, or order issued by the Commission under this chapter. . . ." 47 U.S.C. § 503(b)(1)(B); *see also* 47 C.F.R. § 1.80(a)(2). The statutory basis for the E-Rate program is codified in the very same chapter as the FCC's forfeiture authority, 47 U.S.C. § 503(b). The violations of the E-Rate program rules recounted in the USAC Decision, if true, would appear to fall within the "repeated failure" standard of the FCC's forfeiture authority and thus be governed by the FCC's forfeiture procedure.

If properly handled as a forfeiture, rather than simply refusing to pay for any of the work Lakehills successfully delivered to HISD, USAC could withhold up to $16,000 per violation or per day for a continuing violation with a maximum of $112,500 for any single act. 47 C.F.R. § 1.80(b)(3); *see also* 47 U.S.C. § 503(b)(2)(D). The statute is clear that these maximum forfeiture amounts are not to be applied mechanically, but that the FCC must consider "the nature, circumstances, extent, and gravity of the violation, and with respect to the violator, the degree of culpability, any history of prior offenses, ability to pay, and other such matters as justice may require." 47 U.S.C. § 503(b)(2)(E).[11] The forfeiture penalty against Lakehills exceeds these maximum penalties and was imposed without consideration of any of the required factors.

[11] This is but one more example of a remedy established by Federal statute which, unlike the FCC Rule, requires consideration of the circumstances of the party and equities in fashioning a just remedy. *See* Section III.B, *supra*.

The FCC forfeiture statute also prohibits forfeiture actions for violations that occurred more than a year prior to the FCC providing notice. 47 U.S.C. § 503(b)(6)(B). The FCC's de facto forfeiture action against Lakehills has also ignored this prohibition because all of the alleged wrongdoing associated with the awards occurred more than one year prior to USAC notifying Lakehills that USAC was withholding payment.

USAC, implementing FCC rules, is obligated by both statute and its regulation to cap any forfeiture and to limit the time period in which it can pursue alleged violations. It should not be allowed to escape these obligations by labeling the forfeiture something different.

IV. IF THE FCC WILL NOT CONFINE ITS RULE TO THE LIMITS OF *OPM V. RICHMOND* AND PERMIT CONSIDERATION OF DELIVERED VALUE, IT MUST EXERCISE ITS WAIVER AUTHORITY

In *Schools & Libraries Universal Service Support Mechanism,* Fifth Report and Order, CC Docket No. 02-6, Order, FCC 04-190, 19 FCC Rcd. 15808 (2004), the FCC recognized standards for the granting of waivers from the FCC Rule. The FCC recognized the propriety of such waivers where "the particular facts make strict compliance inconsistent with the public interest." *In the Matter of the Request for Review of the Decision of the Universal Service Administrator by Ysleta Independent School District,* CC Docket 96-45, Order, 18 FCC Rcd. 26407, 26436 (2003). In addition, the FCC may consider "hardship, equity, or more effective implementation of overall policy" on a case-by-case basis. *Id.* The FCC will grant such a waiver if "special circumstances warrant a deviation from the general rule, and such deviation would better serve the public interest than strict adherence to the rule." *Id.* Such special circumstances exist here.

A. Failure to Grant a General Waiver of the FCC Rule Would Cause the Lakehills Trustee and Lakehills Creditors Undue Hardship and Contravene the Overall Purpose of the E-Rate Program

As explained above, a proper FCC Rule for addressing alleged gratuities received in the award and performance of E-Rate contracts should follow established legal principles. These same arguments also support a waiver of the FCC Rule under the particular facts of this case.

Again, it is undisputed that Lakehills and its predecessors successfully completed the underlying E-Rate contract work funded by the Form 471 Applications Nos. 295389, 367296, 377451, 398223, and 398827. There also is no dispute that HISD has retained the benefit of the services provided by Lakehills and its predecessor companies. USAC, however, has failed to uphold its payment obligations in light of Lakehills' successful completion of contractual services, and, instead, has simply applied its unnecessarily expansive FCC Rule. Further, unbeknownst to the Lakehills Trustee, HISD entered into a settlement agreement with the U.S. Department of Justice ("DOJ"), acting on behalf of the FCC, in March 2010, in which DOJ and the FCC released HISD from any obligation to repay E-Rate funding for projects that were funded prior to the settlement and from any FCA or common law actions arising out of HISD's conduct in the award of the subject E-Rate contracts, all in return for the payment of $850,000, a relatively small price to pay compared to what is being demanded of Lakehills. *See* USAC Decision, Tab 34.[12]

Also, it should not be lost in assessing whether a waiver is appropriate here that HISD was an active participant in the conduct which led USAC to rescind the FRNs and seek to

[12] In addition to the USAC action here seeking return of approximately $62 million and refusing to pay at least $20.1 million, DOJ, on behalf of USAC, is seeking recovery of a minimum of $225 million in FCA treble damages directly from Lakehills in its Proof of Claim in the Lakehills' bankruptcy proceeding. *See* Exhibit B.

recover paid amounts from Lakehills. Having released HISD from further liability and by further allowing HISD to retain the benefit of Lakehills' uncompensated labors, USAC and the FCC are laying virtually all the financial burden of the Rule on the Lakehills Trustee.[13] That is simply unfair and wrong. Equitable principles alone require that Lakehills and the Lakehills bankruptcy estate receive compensation for the work Lakehills successfully performed and the Lakehills financial backers financed.

Finally, strict application of the FCC Rule under such circumstances —with no waiver — would require service providers to bear the risk entirely on their own that they might never receive any payment for valuable services provided. It would also discourage potential creditors from investing in E-Rate projects. Such a result violates fundamental principles of fairness and is wholly inconsistent with the aims of the E-Rate program — namely, encouraging service provider participation to improve schools' and libraries' access to telecommunications and information services. Accordingly, strict compliance with the FCC Rule under such circumstances is counter to the public interest, and the Rule should be waived in this circumstance.

B. USAC Apparently Issued Waivers in Other Similar Circumstances

In May 2007, the Federal government brought criminal charges against three individuals arising out of the award of E-Rate contracts by the DISD during the early 2000's. One of the defendants was an official of DISD and the other Frankie Wong of MSE. The defendants were alleged to have engaged in the provision and acceptance of bribes and gratuities in connection

[13] USAC bases its Decision on findings that Lakehills, HISD, Hewlett Packard (Lakehill's equipment supplier) and MSE and. Frankie Wong, among others, engaged in improper contacts during the HISD procurements. Nonetheless, USAC is looking almost solely to Lakehills to make restitution while more active participants such as HISD go virtually untouched.

with the award of those E-Rate contracts. All the defendants were convicted. Upon information and belief, in or about 2005–2006, USAC approved E-Rate payments to MSE for work it successfully performed for DISD. The allegations that led to the convictions were far more serious than those ascribed to the HISD procurements. The Lakehills Trustee is unaware of any action by USAC to recoup those payments as the Rule indicates must occur.

The Lakehills Trustee, through counsel, has filed a Freedom of Information Act ("FOIA") request with the FCC for documents supporting E-Rate payments under the DISD contracts despite the allegations and convictions for bribery and gratuities. The FCC currently has advised counsel that a response will be forthcoming on June 3, 2011. *See* Exhibit E. The Lakehills Trustee reserves the right to supplement this request for review with any relevant information obtained through its FOIA request.

C. A Waiver Is Particularly Warranted for the E-Rate Switch Project Performed Between May and September, 2007

By March 2007, and possibly prior to that date, USAC knew of allegations of competitive bidding violations by ACS regarding the award of the HISD contracts. Jancar Decl. ¶ 6, Attachment B. Yet, despite this knowledge, USAC allowed consolidation of the ACS SPINs into the Lakehills' SPIN in March 2007, to allow Lakehills to bill for work performed by ACS. *Id.* ¶ 5. In addition, Mr. Trifilio of ACS provided a detailed response to the concerns USAC expressed about the HISD contract awards in his April 2007 letter responding to USAC's March 19, 2007 letter. USAC claimed never to have received the April, 2007 letter, although the documentary evidence shows otherwise. *Id.* ¶¶ 8-9. When Lakehills then found that payments from USAC were not forthcoming under the consolidated SPIN, Lakehills made repeated attempts to contact USAC, some successful and many not. *Id.* ¶¶ 14-20. When Lakehills did reach USAC, USAC allowed Lakehills to believe that the delays resulted from routine administrative issues. *Id.* In reliance on this, Lakehills undertook an expedited $17 million project from May to September, 2007, to install switches in HISD schools before the start of the new school year. *Id.* ¶¶ 9-10, 12.

USAC undoubtedly was aware that HISD wanted and needed the switch project completed for the start of the school year and, therefore, had little incentive to tell Lakehills that the delay in its E-Rate payments was due, at least in part if not in whole, to USAC's determination that the FCC Rule would apply. The timing of USAC's notice to Lakehills that Lakehills could expect to be paid nothing for the completed switch project is convincing evidence of this motive. That notice came just days after Lakehills completed the project at the end of September 2007, when Lakehills had spent all the monies for the project, after many previous months of USAC attributing delayed E-Rate payments to administrative issues, and after many unreturned calls from Lakehills to USAC. Jancar Decl. ¶ 20.

USAC's conduct in (1) helping lead Lakehills into the switch project, (2) knowing that Lakehills was proceeding without a full understanding of USAC's unstated intent not to pay Lakehills, (3) waiting until just after Lakehills completed the project before telling Lakehills that payment would be withheld, and (4) allowing HISD to retain everything Lakehills successfully delivered to HISD at no cost to the E-Rate program, offends any sense of fairness and justice. The FCC Rule cannot be read, even now, to permit such a result. USAC's superior knowledge and its conduct during this time period — and the other equitable arguments articulated above — require, at a minimum, a waiver for all FRNs related to the 2007 switch project.[14]

V. CONCLUSION

The FCC Rule which denies payment of E-Rate funds to all parties where there are alleged procurement irregularities is not mandated by any settled law nor is it good public policy. The harsh Rule should reflect accepted legal principles underlying remedies for breaches of legal duties and contracts. At a minimum, the Rule should take into account value delivered by a breaching party, as do virtually all other remedial laws, to avoid an unfair windfall for an undeserving party. If, however, forfeiture is really the intent of the Rule, USAC must follow the FCC's rules on forfeiture, which it has not done here.

Alternatively, if the FCC and USAC decide to continue to implement the Rule as they have expanded it, then a waiver is justified here. Before the bankruptcy forced by USAC's refusal to pay Lakehills, Lakehills delivered valuable and satisfactory goods and services to HISD, and HISD continues to benefit from those efforts. Weighed against this performance and the value delivered to HISD and the Federal government should be USAC's conduct which was far from exemplary. USAC allowed Lakehills to undertake the switch project in mid-2007 without warning Lakehills that payments were jeopardized and waited until the moment of project completion to tell Lakehills that it could expect no payments at all. In addition to these factors, Lakehills, and now the Lakehills Trustee and Lakehills Creditors, are being penalized far more extensively than any of the other parties alleged to have engaged in the procurement improprieties, e.g., HISD. Finally, treating the parties so inequitably will dissuade potential

[14] The amount of E-Rate funding owed to Lakehills from USAC for successful delivery of the switch project is $15,170,494.05. *See* Exhibit A at 4 (FRN 11746486).

vendors and financial backers from participating in future E-Rate programs, and undermine the policy objectives of the E-Rate program.

For all of the foregoing reasons, the Trustee requests that the FCC to reverse the USAC Decision and order USAC to pay the withheld funds to the Lakehills Trustee.

Respectfully submitted,

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